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In spite of the uncertain economic atmosphere we anticipate continued sales growth for the balance of the year. The wide consumer acceptance of our newest product, Cottontelle, currently marketed in the Ontario and Quebec sales divisions, has been encouraging.

For the Board of Directors

A. F. Armstrong
A. F. Armstrong
Chairman
George L. O'Leary
President

Vancouver, B.C.
July 12, 1976

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SCOTT PAPER LIMITED

REPORT TO THE SHAREHOLDERS
For the First Six Months of 1976



SCOTT PAPER LIMITED

CONSOLIDATED STATEMENT OF INCOME

(in thousands except on a per share basis)

	First Six Months 1976	First Six Months 1975
Sales, less discounts and allowances	\$ 51,638	\$ 44,601
Expenses (Note 1):		
Cost of products sold	36,557	32,060
Marketing, general, administrative and development expenses	10,692	9,338
Interest and amortization of debenture issue costs	1,106	929
Income before taxes	48,355	42,327
Provision for taxes on income	3,283	2,274
Income after taxes for the period	1,510	986
Income per share after taxes	<u>\$ 1,773</u>	<u>\$ 1,288</u>
Dividends paid per share	\$2.22	\$1.61
Number of common shares outstanding	800,000	800,000

Note 1—Expenses include depreciation of \$1,808 (1975—\$1,668)
(Unaudited and subject to year end adjustment.)

CONSOLIDATED STATEMENT OF SOURCE AND APPLICATION OF WORKING CAPITAL

(in thousands)

	First Six Months 1976	First Six Months 1975
SOURCE:		
Income for the period	\$ 1,773	\$ 1,288
Add—		
Charges which did not involve an outlay of working capital:		
Depreciation (Note 1)	1,808	1,668
Deferred income taxes	551	530
Amortization of debenture issue costs	21	16
	<u>4,153</u>	<u>3,502</u>
APPLICATION:		
Net additions to fixed assets	2,944	4,538
Dividends	480	480
Purchase of Series A debentures	89	<u>10</u>
Net increase (decrease) of miscellaneous items	(2)	<u>5,028</u>
	<u>3,511</u>	<u>(1,526)</u>
Increase (decrease) in working capital during the period	642	3,859
Add—		
Working capital at beginning of the year	<u>14,426</u>	<u>3,233</u>
Working capital at end of the period	<u>\$ 15,068</u>	<u>\$ 2,333</u>

First half earnings amounted to \$1,773,000 on sales of \$51,632,000 compared with earnings of \$1,288,000 and sales of \$44,601,000 for the same period of 1975.

Earnings per common share were \$2.22 compared to \$1.61 in the first six months of last year. The increase in earnings is compared with a lower level attained in the first half of 1975 which was reduced by charges of approximately 35¢ per share related to anticipated industry-wide labour disruptions and resultant material shortages.

Net income earned in the 1976 period reflects higher volume, the benefits from improved productivity and continuing programs to control costs throughout the company. It should be noted, however, that the 3.4% net return on the sales dollar achieved in the first half of 1976 is well below the 4.0% earned in 1974 and other more normal periods. These returns on sales, on investment, and on shareholders' equity, restricted as they are by government control, are now below those required to support the needed expansion of capacity and the creation of more employment in our various divisions.

The first half results reflect the company's intention and effort to comply fully with the Anti-inflation Program of the Federal Government. Under the prevailing regulations, applicable to pre-tax earnings, the company is allowed 95% of base year margins. During this period the 6.4% before-tax return and the 3.4% after-tax return on sales generated by our company are within the guidelines.

However, the draft regulations announced in May of this year restricting pre-tax profits to 85% of base periods will, unless modified, depress even further the rates of return for the company. This will materially affect our cash flow and our ability to raise capital funds. As a result, Scott Paper Limited, like many others, will have to curtail the planned expansion of production facilities.